S U M M A R I E S

of

Report of Interbureau Coordinating Committee

on

FEDERAL FARM MORTGAGE CREDIT POLICY

These Summaries are in two parts:

1. Summary of recommendations
2. General Summary

Report has been prepared by a subcommittee on each of the following topics:

General Farm Mortgage Credit Policy

Allocation of Control and Responsibility Among National Farm Loan Associations, Federal Land Banks, and Farm Credit Administration

Flexibility in Farm Mortgage Loan Policy

Appraisal and Loan Standards

Farm Debt Adjustment

Names of members of the committees appear at the end of the summaries.

SUMMARY OF RECOMMENDATIONS

In view of the fact that the Federal land banks are the only federally sponsored agencies designed and equipped to serve solvent farmers with long-term credits, the Committee considers it desirable: To improve this service by re-establishing the Federal land banks on a self-supporting basis; to remove the obstacles to the effective functioning of the land bank system on this basis by revising the capital structure of the National Farm Loan Associations and the banks, and by meeting mortgage credit requirements outside the field of these banks through other credit institutions; to improve the flexibility of the loan policy of the land banks and their appraisal and loan standards; and finally to provide for a farm debt adjustment program on a voluntary basis. Hence the following recommendations:

I. GENERAL PROBLEMS OF FUTURE FARM MORTGAGE POLICY.

1. Re-Establishing the Federal Land Banks on a Self-Supporting Basis

a. Authorize the Federal land banks to vary their loan contracts in order to make actual loan rates more nearly commensurate with loan costs and to make the services of the system available to a wider group of potential borrowers.

b. Established and contingent losses be written off and a policy be assumed of paying land bank expenses and absorbing land bank losses in the future from the income earned on their loans.

2. Reducing Future Operating Costs of the Federal Land Banks

a. Establish a more flexible bond-issuing policy, in order to benefit from variations in the short-term as well as long-term money market.

b. Reduce borrowing costs of the Federal land banks through refinancing operations; in order to secure the advantage of present low-money market conditions, consideration should be given to an immediate refunding operation with bonds bearing the same rates as outstanding bonds up to the dates

when outstanding bonds are callable, and lower rates thereafter.

3. Relation of Federal Land Bank Policy to Public Program for Agriculture

The land banks should give, to the public program for agriculture, all cooperation which is feasible within the limits required for performing the function of pace-setting credit institutions on a self-supporting basis.

4. Central Farm Mortgage Bank Functions

Give to the Federal Farm Mortgage Corporation permanent status and wider power to assist the Federal land banks and other farm mortgage lenders through purchasing and selling Federal farm loan bonds as well as farm mortgages held by private credit institutions and to lend upon such mortgages, in order to meet credit stringencies that may occur and to exercise a restraining influence in times of over-expansion.

II. CAPITAL STRUCTURE OF FEDERAL LAND BANKS AND PROFIT AND LOSS DISTRIBUTION WITHIN THE SYSTEM

1. Reorganization Measures to Make the Federal Land Bank System as a Whole More Effective in Meeting Farm Mortgage Credit Requirements

a. Improvement of the Position of Weakened Federal Land Banks and Establishment of a Central System Reserve

(1) Relieve the Federal land banks of the obligation to return in full the surplus paid in by the United States Government, as compensation for the services performed by the banks beyond what should be required of self-supporting credit agencies.

(2) Permit a Federal land bank to transfer funds from the paid-in surplus account to additional reserves for losses and contingencies, if in the judgment of the Governor of the Farm Credit Administration, such transfers are required for supplementing

the existing reserves available for this purpose. Out of the remaining paid-in surplus, an impairment in the legal reserve may be restored.

(3) Pool the balances of such funds in the paid-in surplus accounts, in a central system reserve to be administered by the Governor of the Farm Credit Administration.

b. Maintenance of the Central System Reserve in the Future

Each Federal land bank transfer to the central system reserve, annually, such proportion of its net profits as may be determined by the Governor of the Farm Credit Administration within a legal limit to be established.

c. Issuance of Consolidated Federal Farm Loan Bonds

Limit the issuance of consolidated Federal land bank bonds to 20 times the total amount of the capital stock and surplus of all Federal land banks, minus the total amount of outstanding bonds and notes of individual Federal land banks.

d. Operating Margin

The normal operating spread of the Federal land banks be determined by the Governor of the Farm Credit Administration at a maximum of $1\frac{1}{2}$ percent over (1) the coupon rate of the last long-term Federal land bank bond issue, or (2) the average rate of interest on all outstanding Federal land bank obligations. This margin would not preclude additional charges to meet special expenses or special risks, as for example in the case of the "Turpentine loans".

e. Transfer of Acquired Farms to Other Agencies

Authorize the banks to transfer present holdings and future acquirements of farm real estate to the Federal Farm Mortgage Corporation; and this Corporation, in turn, be authorized to transfer such holdings of real estate to other Government agencies such as the Farm Security Administration, Forest Service, Soil Conservation Service, etc.

3. Reorganization of the Capital Structure of the System

(1) Give new borrowers title to $5 participating stock for each $100 of the loan obtained, but with no initial net asset value.

(2) Exchange the stock of existing national farm loan association for participating stock with a face value equal to the face value of the present stock, and with a net asset value equal to the book value of the present stock. In the case of associations with no impairment, an amount equal to the face value of the existing stock would be credited to each member-borrower on a stock accumulation account; in the case of associations with partially impaired capital stock an amount equal to the face value of the existing stock minus the amount of its impairment would be credited to a stock accumulation account of each member-borrower; and in the case of associations with fully impaired capital stock no amount would be credited to the stock accumulation accounts of their member-borrowers.

(3) Build up stock with no net asset value, or with a net asset value below face value, to its face value out of association profits insofar as such profits are available during the period in which

the borrower's loan is outstanding.

(4) Make provision to eliminate the difficulties resulting from continued ownership of association stock by people who sold their mortgaged farms to other persons.

(5) Provide for the exchange of the Federal land bank stock, held by national farm loan associations or individual borrowers, into participating preference stock in a manner corresponding to that outlined for the exchange of the stock of the national farm loan associations.

(6) Base the bond-issuing capacity of land banks on the net asset value of their participating preference stock.

(7) Retire the association stock held by a member-borrower and apply it to the cancellation of his loan whenever the unimpaired paid-up value of such stock equals the unpaid principal amount of the loan.

(8) Of the Government owned stock, retire annually amounts equal to 25 percent of any increase in the total amount on the stock accumulation accounts of all national farm loan associations in each land bank district.

4. Allocation of Profits and Losses Within the System

(1) Relieve the national farm loan associations of any liability for losses in excess of net worth assets; meet such losses out of undistributed earnings of the Federal land banks and out of their reserves for losses and contingencies, and any legal reserve plus accumulated profits in excess of 5 percent of outstanding obligations; and charge to the central system reserve

losses which cannot be met by the Federal land banks in the manner outlined.

(2) Utilize the earnings of the Federal land bank system in the following manner and order:

(a) The Federal land bank profits - to establish necessary reserves for losses and contingencies, to increase legal reserves, to contribute to the central system reserve, and with the remainder to distribute dividends to national farm loan associations.

(b) The national farm loan association profits - to meet losses, to accumulate necessary contingency reserves, and with the remainder to distribute dividends to the member-borrowers.

5. Utilization of Patronage Dividends of National Farm Loan Associations

(1) Whenever the balance on the stock accumulation account of a member-borrower is below the face value of the corresponding participating preference stock, credit his dividends to his stock accumulation account until the balance of such account equals the face value of his stock.

(2) When the balance on the stock accumulation account of a member-borrower equals the face value of the corresponding participating preference stock, apply his dividends to delinquent installments if there are such; and if there are none, pay to the borrower in cash.

III. FLEXIBILITY IN THE LOAN ACTIVITIES OF THE FEDERAL LAND BANKS

1. Size of Loans

Remove the upper limit for Federal Land bank loans and require

the approval of the Land Bank Commissioner only for loans in excess of $50,000.

2. Security Requirements

(1) Limit the Federal land bank loans to a percentage of the combined normal value of the real estate including the land and improvements thereon, and set such limit at 60 percent.

(2) Make loans up to the maximum of 60 percent of the value of the security only in areas where farm income and land values are relatively stable, and establish, through administrative provisions, lower loan ratios in areas where risks are greater.

3. Repayment Plans

Remove the legal requirements that all loans be amortized and grant authority to the Federal land banks to make straight mortgage loans, or loans with partial amortization of the principal and repayment of the rest through one "balloon payment" at the end of the period; such types of loans should be granted, however, only for periods up to 10 years and in amounts not exceeding 40 percent of the appraised normal value of the mortgage collateral.

4. Advanced Payments on Federal Land Bank Loans

(1) Permit the borrowers of the Federal land banks, in the original loan contract, to make advanced payments, at any time, with the effect of reducing the interest obligations correspondingly.

(2) Provide that no mortgage will be foreclosed solely for the failure of the borrower to make the agreed amortization payments as

long as the total principal payments equal or exceed the total of such payments required under the loan contract.

(3) Give careful consideration to the problem of varying repayment requirements to conform with the fluctuations in farm income, but only within the limits of the land banks' ability to provide such service without incurring greater costs than can be recovered out of income.

IV. APPRAISALS AND LOAN STANDARDS

1. Determination of Land Values and Farm Income

(1) Base appraisals of the value of mortgage collateral and estimates of income for the purposes of recommending loans upon the expected levels of prices, yields, and costs.

(2) In determining the size of a loan that may be made, adopt the probable income available for debt service as the principal factor, together with the probable future value of the security.

2. Valuation of the Mortgage Collateral and Determining the Loan Capacity of a Farm

Continue to regard as separate functions the process of valuing farm real estate security for loans and that of determining the loan-carrying capacity of farms.

3. Appraisal Training

Further develop methods and plans of instruction of appraisers and furnish materials to them which will assist in the various phases of their work.

4. Research in Land Valuation and Loan Standards

Provide for a more comprehensive research program on the factors affecting valuations for long-term mortgage loans and loan

standards, including:

(a) The relation of farm real estate values to farm income, including commodity prices, yields, and costs, and to other factors such as stability of income, real estate market influences, ownership attitudes, transportation facilities, farm layout, community influences, improvements, and other amenities.

(b) The ratio of farm income to land values in relation to interest rates on mortgage loans and alternative investments.

(c) The determination of the point of balance between loan costs and loan returns.

(d) The relation of various classifications of farms according to land productivity, income stability, and other factors and their relation to loan risks.

V. FARM DEBT ADJUSTMENT

1. <u>General Plan Proposed</u>

(1) Provide for debt adjustment on the basis of individual cases, i.e., the particular facts and circumstances comprising each individual farmer's situation should be carefully considered and the conclusions reached should be in keeping therewith.

(2) In the adjustment of debts, give full consideration first to the rearrangement of terms and second to the reduction of amounts; in a particular case either or both might be necessary to accomplish the desired result.

(3) For the services of debt adjustment, organize committees

composed of representative and disinterested local citizens in each county where the need exists.

(4) Base debt adjustment on voluntary acceptance of both debtor and creditor.

(5) All creditors who have claims of any consequence, including the Federal Government or agencies of the Federal Government, may participate in the consideration of the case.

2. Participation by Federal Agencies

(1) In debt adjustment, creditors should be assisted to cooperate with each other and with the debtor so as to realize a net return within the recovery obtainable through other means and to secure the orderly retirement of their claims and investments without resorting to unnecessary court action.

(2) Reductions deemed desirable in unsecured debts or those secured by personal property should be effected at the time the debt adjustment agreement is reached.

(3) Reductions in debts secured by real estate mortgages may be determined immediately or may be deferred by agreement for a specified period of time when the debt-paying capacity of the debtor or the security cannot be estimated satisfactorily at the time the debt adjustment agreement is developed. Likewise, where the amount of the reduction is determined immediately, the final recognition of such reduction may be deferred for a specified period of time under an agreement which will provide that the debtor is to demonstrate his ability to meet the debt payments as adjusted as well as meet other standards of performance which may be agreed upon before the adjustment becomes

fully effective.

(4) Where a substantial reduction is to be effected in debt secured by a real estate mortgage, the debtor, if the creditor agency so desires, should be required to transfer title to the property to the creditor under an agreement that a lease with option to repurchase be given the debtor, providing for a reasonable rental during the lease period, and that the debtor will have a definite right to repurchase the property at the end of the lease period either at a fixed price or at a price to be determined under a method agreed upon in advance.

(5) The purposes and functions of each agency should be observed and participation in a debt adjustment program should not require a credit agency to go outside of its general field of operations. Such participation should not be used as a vehicle to shift the losses and burdens of such credit agencies to some other agency of the Government.

3. Recommended Debt Adjustment Legislation

(1) Grant to Federal credit agencies authority to compromise and reduce farm debts under rules and regulations prescribed by the Secretary of Agriculture in accordance with the general policy recommended.

(2) Set up an organization and facilities under the direction of the Secretary of Agriculture to administer the debt adjustment program described herein; such organization to be separate from any agency engaged in extending credit.

(3) Provide rehabilitation funds to aid in making debt adjustment work most effective; such funds to be provided to the extent

justified by the public interest.

(4) Where additional capital funds are required by a Government credit agency to permit it to participate in the recommended debt adjustment program and still carry out the purposes and functions for which it was created, such additional capital should be supplied to the extent justified by the public interest.

GENERAL SUMMARY

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SUMMARY OF A REPORT OF THE INTERBUREAU COORDINATING COMMITTEE ON FEDERAL LAND BANK POLICY

I. INTRODUCTION

When the Federal land banks were established in 1916 it was intended that they should serve primarily to help farmers obtain, through cooperation, the benefits of efficient, large-scale organization in borrowing. The hope that farmers would obtain cheap mortgage credit service through cooperative enterprises was largely responsible for the choice of this form of organization. Although Federal land bank bonds as well as joint stock land bank bonds were tax-exempt to assist in their sale, the Federal Government assumed no legal responsibility for their payment. Moreover, the provision made for capital contributions by borrowers and for double liability on their stock, clearly indicated that Federal land bank borrowers, as a group, were expected to absorb any losses that might be sustained. It was provided that the borrowing members should be charged rates of interest higher than those paid by the banks and that members should receive as dividends any parts of their payments which were not needed to meet expenses and provide for losses.

In actual operation the Federal land banks diverged considerably, even before the depression, from the lines of development originally planned for them. Farmers never attained a dominant voice in the management of the land banks, although, during the late 1920's, through the

national farm loan associations they became almost sole owners of the banks' stock. Some of the Federal land banks' loans were used for agricultural development but the bulk was used for refinancing existing debts. The Federal land banks, in general, made well-secured loans, but in some areas they became involved with high-risk loans. Although they appeared to be self-supporting during the 1920's, in the case of some of them it is questionable whether adequate provisions were made for the losses that would have occurred on their loans even had agricultural conditions continued as they were during the 1920's.

Opinion differs as to whether effective farmer management of the Federal land banks could have been developed, but there is little question that the tendency during the 1920's was more and more to centralize management. At any rate, the potentialities of cooperative management of the Federal land bank system never were fully tested. The land banks became involved with high-risk loans for several reasons. Most important, probably, was the fact that they first became an important factor in the farm mortgage field just after agricultural prices had turned downward in 1920. A considerable part of their loans was acquired during the early 1920's, when land values were in the beginning stages of the decline that lasted until 1933. Moreover, with the operating spreads limited to 1 percent, most of the Federal land banks were not able to adjust their loan charges in accordance with the risks and costs of making loans to farmers in varying circumstances and in areas of varying risk. Their terms were most attractive to high-risk borrowers. Low-risk borrowers often were able to obtain credit from other agencies on terms and conditions that seemed preferable.

From 1928 to 1933, the Federal land banks were unable to operate effectively. High money rates during most of the period, and the difficult financial position of some of the banks, prevented them from selling bonds at rates that would permit them to lend within the maximum authorized rate of 6 percent. Their new loans were limited largely to the amounts that could be made from collections on outstanding loans. The Federal land banks could thus be of little service to new borrowers during the early 1930's when crushing pressures for liquidation and low farm prices created an urgent need for institutions capable of refinancing farmers' debts and adjusting loan terms to the emergency conditions then prevailing.

So urgent were the needs for refinancing facilities in both urban and farm mortgage credit, that special provision had to be made for them. To relieve the situation in urban mortgage credit, Congress established the Federal home loan banks in 1932 and the Home Owners' Loan Corporation in 1933. To meet the need in farm mortgage credit, the Federal land banks were recapitalized in 1932, and their new bond issues were guaranteed as to interest payments in 1933. The guarantee was used only to a limited extent and was discontinued altogether in 1934, however, when other measures to strengthen the Federal land banks and supplement their activities were adopted. These measures included the establishment of the Federal Farm Mortgage Corporation and the provision for the payment, by the treasury, of surplus funds into the Federal land banks in amounts equal to the amount of the extensions and deferments made by these banks. Congress directed that normal agricultural value, instead of the depressed

current market value of land should be adopted as a basis of appraisals, made provision for liberal extensions and deferments of principal payments, lowered by successive stages the interest rates that could be charged farmers by the Federal land banks and the Federal Farm Mortgage Corporation to the existing level of $3\frac{1}{2}$ percent, and provided for the payment of the difference between the legal interest rate on such loans and the contract rate out of Treasury funds.

From this brief review of the development of the functions of Federal land banks, it may be seen that these banks have never fully attained the cooperative features contemplated in the original farm loan act. The most that could be said of their cooperative features is that they have been federally managed mutual institutions in which farmers have had some part in making and servicing loans and were expected to absorb operating costs and losses. Then the legislation of the early 1930's restricted the liability of the borrowers and required that the Federal land banks relieve debt distress of farmers by refinancing operations, extensions, and deferments. In its final results, this assistance to distressed farmers increased not only the loss burden but also the administrative expenses of the Federal land banks considerably.

The extensions and deferments which the Federal land banks granted their borrowers and the refinancing operations which the Federal land banks and the Federal Farm Mortgage Corporation undertook, helped many thousands of farmers over the worst years of the depression. Debtor difficulties are, however, still widespread in some agricultural areas, and additional measures will be required to improve this situation.

It is important, however, not to exaggerate the need for debt relief. The majority of indebted farmers have been able to carry their obligations and pay prevailing rates of interest without help from the land banks or the Federal Farm Mortgage Corporation. Moreover, new debts are constantly being incurred to purchase and improve farms and to change systems of farming. Such debts are being contracted on the basis of lower values generally prevailing. As these debts become a larger proportion of the total, and as existing excessive debts are reduced through payments, adjustments, or foreclosures, the need for debt relief should diminish. In fact, it is probable that a large percentage of the present borrowers of the Federal land banks, though glad to receive interest reductions, could meet the terms currently offered by other lenders and are in no more need of special debt concessions than are many farmers who have carried on without assistance.

In considering future credit requirements of the American farmers, it has to be borne in mind that great differences exist in the character of these requirements. Farmers not excessively indebted and with adequate income require credit facilities only for obtaining, at moderate cost, loans adapted to the nature of their operations. Farmers whose debt burden exceeds their paying ability need assistance in adjusting their obligations, and often also rehabilitation credits in order to settle an untenable situation. Then there are those farmers whose income is so low that credit, even combined with debt adjustment, does not bring sufficient help to them. The problems of this class of farmer are social as well as economic; in such cases emphasis has to be placed not only on working out involved financial situations, but also on raising living and health standards.

The credit requirements of these different groups of farmers can be classified into four types:

Sound standard-risk credit - that is, credit based on good and durable security and limited to such amounts, in relation to the probable security value and income, as reasonably to assure payment of principal and of interest charges sufficient to cover all costs, including risks.

Extra-risk business credit - that is, credit based on somewhat less desirable security or granted in such amounts, in relation to probable future security value and income, as to involve higher risks and servicing costs, but offering a reasonable expectation of repayment under usual conditions.

Rehabilitation credit - that is, credit extended in conjunction with a welfare program designed to rehabilitate distressed farmers, involving administrative, supervisory and risk costs not charged to the borrower, but having a probability of contract fulfillment.

Relief loans - that is, loans provided for farmers without adequate collateral and without reasonable assurance of payment of either principal or interest, but with a possibility of such payments in the event of favorable circumstances.

Each of these classes of service in the farm mortgage field is indispensable. Yet, each involves methods of approach so peculiar to itself that each class of service will be provided best by a separate agency adequately equipped for the particular task which it has to perform. The field of relief credit is illustrated by the disaster loans. Closely associated are the feed and seed loans and those rehabilitation loans which are not secured by mortgages. Relief loans have been given by the

Government in the past and they will have to be given by it in the future because they are extended to farmers without requiring adequate collateral securities, and often are combined with grants. In the field of rural rehabilitation credit, the Farm Security Administration has been making loans on chattels, and during recent months, also on real estate. This agency has developed a special organization for meeting the involved problems of the excessively indebted farmers and the low-income farmers, who are its borrowers. The extra-risk credit field has been served through the Land Bank Commissioner loans which are made out of the funds of the Federal Farm Mortgage Corporation, and backed by the Government guarantee for this Corporation.

The Federal land banks are the only federally sponsored agency designed to serve solvent farmers with long-term credits and equipped to perform this task. It is believed that the best service will be obtained from the Federal land banks if they are kept free of responsibilities that would take them into fields for which other institutions are, or can be, better suited.

If the provision of sound, standard-risk credit is to be the task of the Federal land banks, the improvement of such service becomes the main question of their future policy. From this viewpoint, the scope and character of the future operations of the Federal land banks and their relation to the Federal Farm Mortgage Corporation will have to be determined. Since the burdening of the system with losses and the impairment of many national farm loan associations hinder the effective

functioning of the Federal land banks, a reorganization of the capital structure of the system and of profit and loss distribution within the system will have to be carried out to reestablish its servicing ability. More flexibility in the loan policy of the Federal land banks is needed to make their services useful to a larger number of borrowers. Improvements in the appraisals and loan standards are required to make the banks better equipped to keep their risks in balance with their income resources. Finally, the problem of farm debt adjustment and of the position of the Federal land banks in a farm debt adjustment program require consideration because the consequences of the depression on farm indebtedness have not yet been sufficiently liquidated.

The report deals with these problems in the following chapters, each prepared by a subcommittee:

I. General problems of future farm mortgage policy.

II. Capital structure of Federal land banks and profit and loss distribution within the system.

III. Flexibility in the loan activities of the Federal land banks.

IV. Appraisals and loan standards.

B. Farm debt adjustment.

II. GENERAL PROBLEMS OF FUTURE FARM MORTGAGE POLICY

1. <u>Re-establishment of the Federal Land Banks on a Self-supporting Basis</u>

The field of services which appears best suited to the particular form of organization of the Federal land banks, is that of extending mortgage credit to farmers on a business basis. There is urgent need for the service of a Federal institution as a pace-setter for the improvement of business credit to farmers and as a yardstick by which the efficiency of private credit institutions can be measured; and the Federal land banks are the only existing mortgage credit institutions that could easily be equipped for this purpose. To carry out such a task they would, however, have to be re-established on a self-supporting basis. This would involve -

a. Writing off established and contingent losses resulting from assisting, during the depths of depression, heavily indebted farmers by refinancing operations, extensions, and deferments;

b. Assuming a policy, in the future, of paying land bank expenses and absorbing land bank losses from the income earned on their loans;

c. Authorizing the land banks to vary their loan contracts and their loan charges in order to make loan rates commensurate with loan costs and to make the services of the system available to a wider group of potential borrowers.

2. Relation of Land Bank Policy to Subsidies

Subsidies in one form or another will be indispensable so long as the Federal land banks are required to maintain a loan rate lower than their real costs. One of the means to reduce future operating costs of the Federal land banks would be a Federal guarantee of their bonds; but the savings, or deferment of payments, the Treasury would achieve through such a guarantee would amount to only about one-sixth of the current interest subsidy (one-fourth of 1 percent per annum).

It seems probable, however, that the Federal land banks with or without Government guarantee of their bonds could reduce their operating cost if they were permitted:

(a) To establish a more flexible bond issuing policy in order to benefit from variations in the short-term as well as in the long-term money market;

(b) To reduce their borrowing costs through refinancing operations; in order to secure the advantage of the present low money market conditions; consideration should be given to

an immediate refunding operation with bonds bearing the same rates as outstanding bonds to the dates when outstanding bonds are callable and lower rates thereafter; and

(c) To pledge all of their mortgages and other earning assets collectively as collateral for outstanding bonds thereby saving the costs of individually pledging such assets.

3. <u>Relation of Federal Land Bank Policy to Public Programs for Agriculture</u>

Since the Federal land banks depend, for their success, on the stability and general welfare of agriculture it seems desirable that they should aid in the public programs designed to secure a satisfactory development of agriculture. In particular, they should give all cooperation which is feasible within the limits required for maintaining a competitive and pace-setting position on a self-supporting basis.

The furtherance of a general program of agricultural adjustment beyond such limits would, however, handicap the servicing ability of the Federal land banks. For example, if a bank should lay down extensive requirements for the borrower's compliance with agricultural programs beyond what the individual borrower himself is willing to undertake, he would be likely to seek a loan elsewhere, especially if his credit rating is good. Moreover, less than one-tenth of all farmers are land bank borrowers, and the amount of compliance which could be secured in connection with mortgage loans would represent a small part only of what would be required for the success of production adjustment and land use programs. Nevertheless, it appears clear that the land banks, as well as other

lenders, may strengthen their own positions as well as serve the general objectives of agricultural programs through cooperation with other agencies established for planning and administration of public programs in agriculture.

4. Need for the Central Farm Mortgage Banking Functions

The division of work between the Federal land banks and the Federal Farm Mortgage Corporation has been based on the assumption that the former would confine their loans to good credit risks and would rely upon the soundness of their loans for their ability to borrow, whereas the latter would accept higher risks and therefore necessarily have to depend upon the Government credit for its ability to borrow.

Under present conditions this distinction is, however, of limited importance. The land banks do not charge enough for their services to cover their costs and losses, and they are only in a degree less dependent upon the Government credit than the Federal Farm Mortgage Corporation. Moreover, both the Federal land banks and the Federal Farm Mortgage Corporation have been used, during recent years, to perform central mortgage banking functions.

If in the future the land banks are to be made self-supporting and dependent on their own financial strength for their ability to borrow, the responsibilities for performing central farm mortgage banking functions should be concentrated in the Federal Farm Mortgage Corporation, and permanent status should be given to this corporation in order that assistance by this corporation will be readily available if it should be needed again in an emergency situation. Such assistance should, however, not be

confined to the Federal land banks, but should be made accessible also for other institutions granting farm mortgage credits.

> To enable the Federal Farm Mortgage Corporation to assist the Federal land banks and other farm mortgage lenders, it is recommended that it be given wider power for purchasing and selling Federal land bank bonds, and authorize it also to purchase and sell, and to lend upon, farm mortgages held by private credit institutions.

The corporation's holdings of bonds and mortgages would normally increase in times of general credit stringency and decrease in times when the other lenders could furnish most mortgage credit requirements. If elastic powers were given to the corporation with regard to its lending and bond purchasing operations, it should be able to prevent the recurrence of such conditions as arose during the early 1930's.

III. CAPITAL STRUCTURE OF FEDERAL LAND BANKS AND PROFIT AND LOSS DISTRIBUTION WITHIN THE SYSTEM

The unfavorable financial position of some of the Federal land banks as a result of heavy losses encountered in the last decade, the substantially increased financial participation of the Federal Government in these banks, together with the uncertainty of its continuation, and the handicaps to an effective loan service which resulted from the impairment of the capital stock of two-thirds of the national farm loan associations, - all suggest the need for a careful reappraisal of the financial organization of the Federal farm loan system. If the system is to be an effective medium for supplying farm mortgage credit at low rates to sound credit risks, it is obvious that material changes will have to be made in the financial operations of the banks and the associations as well as in their relative responsibilities. The reorganization problems involved in such an attempt are discussed under the following subsections:

1. Desirable reorganization measures to make the Federal land bank system as a whole more effective in meeting farm mortgage credit requirements

2. Increasing the effectiveness of the functioning of the national farm loan associations

3. Reorganization of the capital structure of the system

4. Allocation of losses and profits within the system

1. Desirable Reorganization Measures to Make the Federal Land Bank System as a Whole More Effective in Meeting Farm Mortgage Credit Requirements

a. Improvement of the Position of Weakened Federal Land Banks and Establishment of a Central System Reserve

By directing the land banks to grant extensive deferments and extensions and to embark on a vast refinancing program without sufficient time adequately to develop a full appraisal force, Congress placed the Federal

land banks in a position to assume greatly increased risks in their loan operations. On the other hand, these operations have benefited a large number of farmers and materially strengthened insurance companies, commercial banks, local merchants and others through refinancing agricultural loans at a time when no other refinancing facilities were available.

To enable the Federal land banks to carry the burden resulting from these emergency measures, Congress appropriated funds for an increase in their capital stock, granted interest subsidies, and directed the Treasury to pay into these banks, as paid-in surplus, amounts equal to the total amount of extensions and deferments granted to land bank borrowers. The banks are further permitted to utilize the surplus, which has been paid in by the United States Government, for meeting losses after having used up their legal reserves for this purpose; the banks have, however, to restore, out of future profits, any impairment of paid-in surplus.

These provisions have not worked satisfactorily as they have not provided sufficient assistance for those banks most in need of financial aid. The banks which had large legal reserves were in a position to meet losses out of current and undistributed profits. Other banks which were unable to do this also were not able to accumulate more than small legal reserves; using these reserves for meeting losses weakened their position, and has increased the difficulties particularly of one bank which had to use up all its legal reserves for meeting losses.

In view of this situation the committee suggests that:

(1) The Federal land banks be relieved of the obligation to return in full the surplus paid in by the United States Government as compensation for the services performed by the banks over and above those originally contemplated under the Federal Farm Loan Act.

(2) A Federal land bank be permitted to transfer funds from the paid-in surplus account to additional reserves for losses and contingencies, if in the opinion of the Governor of the Farm Credit Administration, such transfers are positively required for supplementing the existing reserves of this kind. Out of the remaining paid-in surplus, an unrestored impairment in the legal reserve may be restored.

(3) The balances of such funds in the paid-in surplus accounts be pooled in a central system reserve to be administered by the Governor of the Farm Credit Administration.

(4) The Governor be authorized the utilize, for additional stock subscriptions to banks in need of increased capitalization, that part of the funds transferred from paid-in surplus to the central system reserve account which he considers as not necessary for meeting losses.

b. Maintenance of the Central System Reserve in the Future

The committee believes that the principle of meeting, on a Nation-wide basis, losses which seriously impair the position of an individual land bank should be made a permanent feature of the system so as to conform with the principle of the joint liability which all banks have assumed in issuing consolidated Federal farm loan bonds.

It is, therefore, suggested that each Federal land bank transfer to the central system reserve, annually, such proportion of its net profits as may be determined by the Governor of the Farm Credit Administration within a legal

limit to be established.

c. Issuance of Consolidated Federal Farm Loan Bonds

The liability for the consolidated Federal farm loan bonds rests upon the Federal land banks not individually, but jointly; if, in addition, the suggested provisions for a Nation-wide distribution of losses should be carried out, the issuing capacity with regard to consolidated Federal farm loan bonds could be determined jointly for all 12 banks.

> It is recommended that the issuance of consolidated Federal land bank bonds, in the future, be limited to 20 times the total amount of the capital stock and surplus of all Federal land banks, minus the total amount of outstanding bonds and notes of individual Federal land banks.

d. Operating Margin

A necessary requirement for efficient organization and operation of the system is the provision for sufficient earnings. It is felt that an increase in the spread to $1\frac{1}{2}$ percent will allow for operating costs and the covering of losses, and still pay back to the borrowers, in good areas and successful associations, dividends that will have the effect of reducing their rate of interest.

> The committee recommends that the normal operating spread of the Federal land banks be determined by the Governor of the Farm Credit Administration at a maximum of $1\frac{1}{2}$ percent over (1) the coupon rate of the last long-term Federal land bank bond issue, or (2) the average rate of interest on all outstanding Federal land bank obligations. This margin would not preclude additional charges to meet special expenses or special risks, as for example in the case of the "Turpentine loans."

e. Transfer of Acquired Farms to Other Agencies

The present high operating costs of the Federal land banks are in large part due to the expenses involved in handling acquired farm properties. Since the ability of the system to supply low-cost credit through dividend distributions to borrowers will be dependent on reducing its operating expenses, it seems desirable to eliminate the heavy real estate holdings. Such a transfer would enable the Federal land banks to reduce their operating costs and to concentrate all their activities on the normal lending operations of the system.

> It is, therefore, suggested that the banks be authorized to transfer present holdings and future acquirements of farm real estate to the Federal Farm Mortgage Corporation; and that this Corporation, in turn, be authorized to transfer such holdings of real estate to other Government agencies such as the Farm Security Administration, Forest Service, Soil Conservation Service, etc.

2. <u>Increasing the Effectiveness of Functioning of National Farm Loan Associations</u>

It is the view of the committee that the national farm loan associations perform useful and needed services in the Federal farm loan system. They should, therefore, be strengthened and more effort should be made to obtain increased participation by members of these associations. In addition, provision should be made for the improvement of the cooperation between them and other local service agencies operated under the Farm Credit Administration. The individual farmer has one problem of financing. If it were possible to coordinate short-term and long-term credit facilities through

unification of the servicing agencies from the top down, one loan committee would then have to analyze the farmer's situation and to value his assets and his paying ability; and this committee would be in a position to recommend the total credit justified in the circumstances and what portions of this total should be extended on a long-term, on an intermediate-term, and on a short-term basis.

On the basis of such considerations it is recommended that steps be taken:

(1) To eliminate present overlapping of national farm loan association territories, preferably through consolidation,

(2) To give local directors and committees thorough training.

(3) To give careful consideration to the possibilities of unifying all credit facilities under the Farm Credit Admininstration into one system represented locally by a consolidated association.

3. Reorganization of the Capital Structure of the System.

Since the effectiveness of the functioning of the national farm loan associations, and of the system as a whole, is handicapped by the present capital structure of the Federal land banks and the associations, it seems desirable to reorganize this capital structure, so that in the future borrowers would no longer have to pay in the $5 capital stock; and so that using funds acquired through stock accumulation by a national farm loan association to meet losses will not interfere with its ability to service loans for the Federal land banks. To achieve this purpose, it seems desirable that participating stock with no net asset value be issued to new borrowers; that the existing stock of national farm loan associations be exchanged into participating

stock of equal face value but of a net asset value which is to be determined on the basis of the book value of the present association stock; and that all stock with a net asset value below face value be built up, out of association profits, to a maximum of $5. Likewise the stock of the Federal land banks held by associations or borrowers would have to be exchanged into participating preference stock.

This change in capitalization would involve the following provisions:

(1) New borrowers would be given title to $5 participating stock for each $100 of the loan obtained, but no initial net asset value would be attached to such stock.

(2) Existing national farm loan association stock would be exchanged for participating stock with a face value equal to the face value of the present stock, and with a net asset value equal to the book value of the present stock. In the case of associations with no impairment, an amount equal to the face value of the existing stock would be credited to each member-borrower on a stock accumulation account; in the case of associations with partially impaired capital stock an amount equal to the face value of the existing stock minus the amount of its impairment would be credited to a stock accumulation account of each member-borrower; and in the case of associations with fully impaired capital stock no amount would be credited to the stock accumulation accounts of their member-borrowers.

(3) Stock with no net asset value, or with a net asset value below face value, would be built up to its face value

out of association profits insofar as such profits are available during the period in which the borrower's loan is outstanding.

(4) To eliminate the difficulties resulting from continued ownership of association stock by people who sold their mortgaged farms to other persons, provision would have to be made that:

(a) In the future, the borrower's membership in his association shall end when he gives up, or loses, the ownership of the mortgaged farm;

(b) Each borrower be required to authorize the Federal land bank to dispose, in his name, of the stock and any interest in it, including dividends distributed on such stock, to any successor in the ownership of the mortgaged farm, and without entitling him to any consideration except if the ownership of the farm is transferred by sale and the consideration for the stock forms part of the purchase price of the farm.

(5) Provision would have to be made for the exchange of the Federal land bank stock which is held by national farm loan associations or individual borrowers into participating preference stock in a manner corresponding to that outlined for the exchange of the stock of the national farm loan associations.

(6) The net asset value of the participating preference stock of the land banks would form the basis for the bond-issuing capacity of banks.

(7) The association stock held by member-borrowers would be retired and applied to the cancellation of the loan whenever the unimpaired paid-up value of such stock equals the unpaid principal amount of the loan. Corresponding amounts of the participating preference stock of the Federal land banks would be retired simultaneously.

(8) Of the Government owned stock, annually, amounts would be retired equal to 25 percent of any increase in the total amount on the stock accumulation accounts of all national farm loan associations in each land bank district.

4. Allocation of Profits and Losses Within the System

The past history of the Federal land bank system has shown that the area in which a national farm loan association operates is so small that the association frequently cannot obtain diversification of risks. Frequently a few losses in a single association will exceed the amount available on the accounts of its capital stock, its reserves, and its undistributed profits. On the other hand, the Federal land banks do not recover, from the association, losses in excess of its net worth assets and earnings. In view of this experience, the unworkable principle of unlimited liability of the national farm loan associations for losses on Federal land bank loans could well be abolished. Instead of that a more practical allocation of legal responsibility for losses on such loans should be established. Since lending is a joint function of bank and association, the legal responsibility for the loans made should be carried by both types of institutions. A national farm loan association cannot be considered as an individual cooperative in the sense in which we think of local cooperative purchasing associations, but rather the Federal land bank system must be conceived as a system of

cooperative sharing of risks, formerly on the basis of land bank districts and, with the marketing of consolidated Federal land bank bonds, on a Nation-wide basis.

In recognition of the actual responsibility for assuming losses and in keeping with the principle of the cooperative sharing of risks which characterizes the Federal land bank system as a whole, the committee recommends, therefore:

(1) That the national farm loan associations be relieved of any liability for losses in excess of net worth assets; that such losses be met by the Federal land banks out of undistributed earnings, reserves for losses and contingencies, and any legal reserve plus accumulated profits in excess of 5 percent of outstanding obligations; and that the central system reserve be charged for losses which cannot be met by the Federal land banks in the outlined manner.

(2) That earnings of the Federal land banks system be utilized in the following manner and order:

(a) The Federal land bank profits - to establish necessary reserves for losses and contingencies, to increase legal reserves, to contribute to the central system reserve, and with the remainder to distribute dividends to national farm loan associations.

(b) The national farm loan association profits - to meet losses, to accumulate necessary contingency reserves, and with the remainder to distribute dividends to their member-borrowers.

5. <u>Utilization of Patronage Dividends of National Farm Loan Associations</u>

To conform with the suggestion made above for the accumulation of stock for borrowers out of dividends, the dividends distributed by national farm loan associations would be utilized in the following manner:

(1) Whenever the balance on the stock accumulation account of a member-borrower is below the face value of the corresponding participating preference stock, his dividends would be credited to his stock accumulation account until the balance of such account equals the face value of his stock.

(2) When the balance on the stock accumulation account of a member-borrower equals the face value of the corresponding participating preference stock, his dividends would be applied to delinquent installments if there are such; and if there are none, paid to the borrower in cash.

IV. FLEXIBILITY IN THE LOAN ACTIVITIES OF THE FEDERAL LAND BANKS

Since agricultural conditions vary greatly among different sections of the country, and incomes of farmers fluctuate considerably from time to time due to changes in production and prices, a federally sponsored farm mortgage system which attempts to serve farmers over the entire country must maintain a flexible loan policy in order to meet satisfactorily the credit needs of farmers and to obtain a balance between its costs and returns. In some respects the Federal land banks have been granted sufficient authority to vary their loan policy in accordance with the variations in the credit needs of the farmers; for example with regard

to the purposes and to the terms of years for which loans may be granted; in other respects, however, provision seems required for securing more flexibility in the loan policy of the Federal land banks. This is the case particularly with regard to:

1. Size of loans
2. Security requirements
3. Repayment plans
4. Advanced payments on Federal land bank loans

1. Size of Loans

Under present restrictions no loan may be made by the Federal land banks for less than $100 and the total of loans to any one borrower may not exceed $50,000. Loans exceeding $25,000 must be approved by the Land Bank Commissioner. It is considered that under efficient administration there is no need for Commissioner approval of loans of less than $50,000, which in general should be the limit for land bank loans. In special cases, where a borrower can offer sufficient security for a larger loan, but cannot obtain such a loan on a satisfactory basis from other sources, the land banks should, however, be permitted to grant loans also in excess of $50,000.

> It is suggested that the legal restrictions might be changed by removing the upper limit for Federal land bank loans and by requiring the approval of the Land Bank Commissioner only for loans in excess of $50,000.

With regard to the maximum of the so-called Commissioner loans, which are granted by the Federal Farm Mortgage Corporation, there appears to be no good reason for increasing this maximum above the present amount

of $7,500.

2. Security Requirements

Under present laws, Federal land bank loans may not exceed 50 percent of the appraised value of land plus 20 percent of the value of permanent insured improvements. Since land and buildings together make up the farm units, separate values on each of them are more or less arbitrary.

It seems desirable:

(1) To amend existing laws so as to limit Federal land bank loans to a percentage of the normal value of the real estate including the land and improvements thereon, and to set such limit at 60 percent;

(2) To make loans up to the maximum of 60 percent of the value of the security only in areas where farm income and land values are relatively stable, and to establish, through administrative provisions, lower loan ratios in areas where risks are greater.

No change is recommended with regard to the present limit of 75 percent for Commissioner loans.

3. Repayment Plans

At present the statute requires that every Federal land bank mortgage loan "shall contain an agreement providing for the repayment of the loan on an amortization plan by means of a fixed number of annual or semiannual installments." Within this legal limit three kinds of repayment plans are now recognized: First, the equal payment plan where the annual or semiannual installments which include principal and interest

are of equal amount during the period of the loan; second, the decreasing payment plan, usually referred to as the Springfield plan, where equal payments on the principal are called for but, since interest is paid annually on the actual amount of principal outstanding, the total annual or semiannual payment decreases during the period of the loan; third, the increasing payment plan.

The equal payment plan appears to meet the needs of farmers in areas where the income is reasonably stable and where the security is likely to maintain a fairly stable value over a period of years. The decreasing payment plan is particularly suited to loans where the real estate may be subject to deterioration or where the income of the farmer is likely to decline. In areas where buildings constitute a large share of the value of the real estate a decreasing payment plan may result in fairly large payments during the early years of the loan, and may provide adequate security even though buildings are depreciating and declining in value. Similarly in areas where erosion or decline in fertility lowers the income of farmers, the decreasing payment plan is desirable. Loans secured by fruit trees, where production is expected to decline as the result of increased age of trees, may be made to advantage on the basis of decreasing payments. The increasing payment plan has not been widely adopted. However, there are cases where a farmer wishes to use his income during the early years of the loan to improve the buildings, build up his livestock, add to his equipment, etc., and would find it desirable not to make any payment or very small payments on principal during the early years of the loan. If his earnings are used for productive improvements on the farm, this should increase his income in later years when increasing payments are required.

By selecting the suitable type of repayment plans the obligations of the borrower can be adjusted to his peculiar situation in all cases in which, under given terms, the loans can be granted for sufficiently long periods without impairing the safety of the lender. This is possible in stable agricultural areas where farming is diversified and income fairly regular. In less stable agricultural areas where income is largely dependent upon staple or specialty crops, shorter term loans, for example 10-year loans, may, however, often be more desirable from the standpoint of the creditor than 30 or 40-year loans which would enable the borrower to pay off the principal through amortization installments. The security of the creditor, on the other hand, would not be handicapped when no repayments or only partial repayments are being made during a 10-year period and it is left to his discretion to renew the outstanding balance of the debt at the end of such period when in his consideration the security warrants such a renewal. In addition to these cases in which the creditor's interest demands a shorter term loan, there exist cases also where farmers, for one reason or another, wish to carry a certain amount of debt without reducing it by amortization payments.

To enable the Federal land banks to supply loans also in cases of the described types it is recommended:

> To remove the legal requirements that all loans must be amortized and to give the land banks authority to make straight mortgage loans, or loans with partial amortization of the principal and repayment of the rest through one "balloon payment" at the end of the period; such

types of loans should be granted, however, only for periods up to 10 years and in amounts not exceeding 40 percent of the appraised normal value of the mortgage collateral.

4. Advanced Payments on Federal Land Bank Loans

Advanced payments of the outstanding principal of the loan, or of a portion of the principal, are permitted by the statute after 5 years from the date of the loan; and in practice are being accepted even before this date. Such advanced repayments are applied to shorten the term of the loan; in other words, the borrower may pay up in advance any number of installments next to come due and then continue with the regular amortization schedule. Making such advanced payments does not, however, release the borrower from the obligation to pay regular installments; technically his loan may even be foreclosed in subsequent years because of a failure on his part to meet installments which become due after the advanced payments were made.

On the other hand, in periods of favorable income it is desirable for farmers to bring up reserves or to make payments on debts which will protect them in years of low income which are likely to follow. The Farm Credit Act of 1937 made provision, therefore, for the acceptance of "conditional payments" on Federal land bank loans, the interest rate paid by the Federal land banks usually has been 1 percent below the contract rate but not in excess of 3 percent. Up to June 30, 1940 the total of the conditional payments amounted to only $243,298.57. The fact that agricultural conditions have not been particularly favorable during the few years in which such conditional payments have been accepted, may to some

extent be responsible for the limited use which has been made of this facility; but it seems probable that other reasons also have handicapped the success of that conditional payment scheme - such as: The fixing of the interest rate for such payments below the loans rate; the requirement that the borrower sign a formidable agreement of some 1,500 words if he wishes to make conditional payments; and the fact that he loses control of the funds so used, whereas, if he accumulates them on a savings account he can keep them available for any purpose for which he may need them in the future.

In view of the unsatisfactory success of the present conditional payment scheme it seems advisable to substitute for this scheme another one which would enable Federal land bank borrowers to make advanced payments in favorable years in a simpler manner, but with the effect of relieving them correspondingly from the obligation to pay principal installments during years of low income. In addition, the problem of varying repayment requirements to conform with the fluctuations of farm income demands serious consideration.

It is recommended that:

(1) The borrowers of the Federal land banks be permitted in the original loan contract to make advanced payments, at any time, with the effect of reducing the interest obligations correspondingly;

(2) Provision be made to secure that no mortgage will be foreclosed solely for the failure of the borrower to make the agreed amortization payments as long as the total principal payments equal or exceed the total of such payments required under the loan contract.

(3) Careful consideration be given to the problem of varying repayment requirements to conform with the fluctuations in farm income, but only within the limits of the land banks' ability to provide such service without incurring greater costs than can be recovered out of income.

V. APPRAISALS AND LOAN STANDARDS

1. Determination of Land Values and Farm Income

The fluctuations that have occurred in land values in the United States during the last quarter century have been of sufficient magnitude to indicate that the gauging of general value levels and trends constitutes one of the major uncertainties associated with the problem of extending farm mortgage credit.

The upward movement in farm real estate values during and immediately after the first World War carried values for the country as a whole to a peak which was 70 percent above the 1912-14 average. During the 1920's land values declined by about one-third. An even larger decline followed in the early 1930's, and the lowest level was reached in 1933. The land values of this year equalled about 40 percent of the 1920 level and about 75 per cent of the pre-war average. During the following 4 years, land values rose moderately each year so that in 1937 they reached a level 16 percent above that of 1933, but still 15 percent below the 1912-14 average. Since 1937 the general level of values for the country as a whole have been substantially unchanged.

To any lending agency, which seeks to provide maximum service on a sound credit basis, the fluctuations in farm income are, however, of even greater importance than the fluctuations in land values, because the borrower's ability to repay loans depends on his income. Since, in the long run, land values are also influenced by the development of farm income, estimating the farm income becomes of particular importance for farm mortgage institutions. Several factors contribute to the determination of that part of the farm income which is available for servicing and repaying loans.

These factors are: (1) The quantity of production, which in the case of crops is equal to the acreage multiplied by yields; (2) the prices received for the products; and (3) the costs incurred in production including taxes and a reasonable allowance for family living. Any surplus remaining after the first two are multiplied and the latter subtracted may be considered income available for supporting loans. Of these factors, the one which is subject to the greatest fluctuations and therefore has the greatest influence on farm income, is in general the prices of agricultural commodities.

It must be recognized, however, that prices cannot be predicted with accuracy for periods of 20 years or more as is generally required in farm mortgate credit. Rather than predict price movements, it should, therefore, be attempted to ascertain a prevailing level of future prices about which the fluctuations are likely to occur. Although future price movements themselves cannot be forecast, it seems probable that the underlying equilibrium situation will persist, and that prices will exhibit a tendency to return to normal levels. After making adjustments for changes, of a fundamental nature, in production, consumption, and prices, past normal levels may therefore be accepted as feasible estimates for the levels which may be expected to prevail over a long-term future period.

In a similar manner the concept of normality can be adapted to the estimation of production and costs. Estimates of future yields of crops on farm land can be based upon averages of yields obtained in years of normal growing conditions with due allowance for technological changes, such as the introduction of hybrid corn. Cost estimates likewise can be averages of cost experience on farms under usual circumstances, adjusted for known alterations in farming conditions such as the replacement of horses by tractors.

Neither the yield nor the cost estimates, however, can be generalized by areas to the same extent as prices. Those estimates must be formulated more on an individual farm basis, and must be consistent with actual practices under accepted income conditions. This is true because, even within one and the same area, farms lack sufficient uniformity in size, soils, topography, and other factors influencing yields and costs.

In view of the historical trends in land values, farm income, and farm commodity prices, and of the difficulties of forecasting future developments, it is recommended that:

(1) Appraisals of the value of mortgage collateral and estimates of income for the purposes of recommending loans should be based upon expected levels of prices, yields, and costs of farm products, as well as on that of other pertinent normal relationships.

(2) In determining the size of a loan that may be made the probable income available for debt service shall be regarded as a principal factor together with the probable future value of the security; ordinarily the income considered will be limited to that derived from agricultural production. On some farms, however, the availability of stable income from outside sources, or of reliable alternative-use values may make prudent a larger loan than the actual agricultural income would support.

2. Valuation of the Mortgage Collateral and Determining the Loan Capacity of a Farm

Although appraisals of farms and recommendations of loans may be performed by one and the same person, there is a definite distinction between these two functions. Appraisals center attention upon the value of the security, while the recommendation of a loan requires that greater attention be paid to the income which will be available for the repayment of loans.

> The process of valuing farm real estate security for loans and that of determining the loan-carrying capacity of farms should therefore continue to be regarded as separate functions.

3. Appraisal Training

The committee feels that instruction of appraisers is an important function of the Farm Credit Administration, and recognizes a dearth of printed material in the rural appraisal field.

> It is therefore considered necessary that methods and plans of instruction be carefully worked out and that materials be furnished to appraisers which will assist them in the various phases of their work. The instructions should include training in the principles of appraising real estate as well as in the extension of credit.

4. Research in Land Valuation and Loan Standards

The committee considers it necessary that further research work be undertaken as a guide to the establishment of loan and appraisal standards.

> It is recommended that a comprehensive research program be set up on the factors affecting valuations for long-term mortgage loans and loan standards. Among the problems needing further research are:

(a) The relation of farm real estate values to farm income, including commodity prices, yields, and costs; and to factors having a greater influence than reflected in income alone, such as stability of income, real estate market influences, ownership attitudes, transportation facilities, farm layout, community influences, improvements, and other amenities.

(b) The ratio of income to value in relation to interest rates on mortgage loans and alternative investments.

(c) The determination of the point of balance between loan costs and loan returns.

(d) The relation of various classifications of farms according to land productivity, income stability, and other factors and their relation to loan risks.

VI. FARM DEBT ADJUSTMENT

1. The Problem

A substantial volume of farm debts was readjusted during the period of extensive refinancing operations of the Federal land banks and the Federal Farm Mortgage Corporation. Also, voluntary debt adjustment carried on by county and State debt adjustment committees under the supervision of the Farm Security Administration resulted in substantial adjustments. A total of 137,151 individual cases were adjusted under the Farm Security Administration program in the period from September 1, 1935 through November 30, 1940. Over $427,000,000 of farm debt was involved in such voluntary adjustments with an aggregate debt reduction of over $96,000,000, or 22.6 percent. Of these 137,151 cases adjusted on a voluntary basis, 83,078 involved debt reductions, 1,094 substantial interest-rate reductions, 29,078 extensions, and the remainder involved combinations of methods and other miscellaneous cases. An indication that debt adjustment has not been confined entirely to private lenders is seen in the fact that from 1932 through 1939 the Federal land banks and the Federal Farm Mortgage Corporation have provided for extensions, reextensions, deferments and reamortization on a substantial portion of their loans. To all of these more or less formal debt adjustments should be added, of course, a large number of informal adjustments between private lenders and their creditors.

The debt adjustments still required appear to be largely concentrated in certain areas. As regards the mortgage loans of the Federal land banks and the Federal Farm Mortgage Corporation, high delinquency is confined largely to the Northern Great Plains and the Southeastern States. As of the end of 1939, almost 73 percent of the Federal land bank loans and over

86 percent of the Federal Farm Mortgage Corporation loans in North Dakota were delinquent or extended. In contrast, only 7.3 percent of the Federal land bank loans and 9.1 of the Federal Farm Mortgage Corporation loans in Indiana were delinquent or extended on that date. Variations in the seriousness of the problem in different areas is indicated also by the fact that for North Dakota the total amount due and payable by borrowers during 1939 on Federal land bank loans was equal to 27.3 percent of the loans outstanding at the beginning of the year, whereas the percentage for Minnesota was 6.5 percent.

Not only are there wide regional variations in the severity of the farm debt situation, but there are also wide variations among individual borrowers as regards the causes of their difficulties, the character of existing debts, and the extent to which debt adjustment promises to provide an effective solution.

2. Objectives

The specific objectives of this program may be stated as follows:

Public: To alleviate the burden on society of delinquent and excessive farm debts, and to reduce and keep to a minimum the social cost of forced liquidation of such indebtedness resulting in the unnecessary eviction and resettlement of competent farm owners and operators.

Debtors: To adjust the debts of worthy distressed farm debtors so as to bring the amounts and repayment terms of their debts within their present and prospective ability to pay.

Creditors: To enable the creditors of a worthy distressed debtor to cooperate with each other and the debtor in such

a manner as to realize a net return equal to the possible recovery obtainable through other means and to aid in the orderly retirement of their investments and claims without resorting to unnecessary court action.

3. General Plan Proposed

Since it is frequently the entire financial situation of the farmer and perhaps his entire farming program, rather than merely his mortgage debt to the Federal institutions, that needs to be considered in debt adjustment, the recommended debt adjustment program is based on the assumption that the problem of debt adjustment will be attacked on an individual case basis and with the principal objective of bringing about improvements in the farmer's entire debt situation.

Two other fundamental considerations involved in the recommendations contained herein are particularly significant, namely, that adjustments be effected on a voluntary basis and that such adjustments be worked out through local committees. Legal processes are now available for the adjustment of debts on an involuntary basis but such processes apparently fall short of an acceptable solution to the problem in a large number of instances. The use of local committees follows the concepts of decentralization and local participation which now prevail in many agricultural programs and, in addition, their use appears to afford certain safeguards which would otherwise be extremely difficult to obtain.

On the basis of a consideration of the diversity of problems, the possible limitations, and the feasible objectives of farm debt adjustment, it is believed that the following are the basic factors that should govern the formulation of a sound debt adjustment program:

(1) Debt adjustment should be pursued on the basis of individual cases, i.e., the particular facts and circumstances comprising each individual farmer's situation should be carefully considered and the conclusions reached should be in keeping therewith.

(2) In the adjustment of debts, full consideration should be given first to the rearrangement of terms and second to the reduction of amounts; in a particular case either or both might be necessary to accomplish the desired result.

(3) The services of debt adjustment committees composed of representative and disinterested local citizens should be made available in each county where the need exists. The function of such committees would be to assist debtors and creditors in working out voluntary adjustments of debts upon a basis beneficial to each. These committees should be independent of debtor and creditor groups (including creditor agencies of the Government) to assure their freedom from pressure and aid in the maintenance of an unbiased approach in the consideration of the cases presented to them.

(4) The acceptance of the adjustments proposed should be on a voluntary basis for both debtor and creditor, i.e., neither would be required by law to accept the recommendations of the debt adjustment committee and the legal rights of the respective parties would in no way be impaired because of the failure to accept such recommendations.

(5) All creditors who have claims of any consequence, including the Federal Government or agencies of the Federal Government, should participate in the consideration of the case. It does not follow that the claims of every creditor will necessarily be rearranged or reduced but rather that all creditors will cooperate fully and participate in the adjustment in an equitable manner.

4. Participation by Federal Agencies.

Current efforts to reduce delinquent and excessive agricultural indebtedness have been seriously handicapped because most Federal credit agencies are prohibited from compromising or scaling down their loans. Reduction in the excessive debt of worthy and competent distressed farm debtors has, therefore, been limited to those with no Federal loans or to the adjustment of their private debts to the exclusion of those held by the Federal agencies. Frequently, the existence of an excessive Federal debt which cannot be reduced or compromised handicaps other creditors in making needed and advantageous rearrangements of the terms of payment of their adequately secured debt. This has been a handicap to the debt adjustment work of the Farm Security Administration. It is readily apparent that the full participation of the Federal agricultural credit agencies is essential to the success of any comprehensive debt adjustment program.

Since the participation of the Federal credit agencies in a farm debt reduction program would for the most part be a new endeavor and represents an outstanding change from an established precedent, the general policies to be followed by these agencies should be carefully developed.

In the circumstances it is believed that a general definition of policy on the part of Congress would be extremely desirable in effecting coordination between agencies as well as avoid, perhaps, other problems which might arise if action on the part of Congress is limited to the bare legal authority necessary to carry out such a program. The major points which it appears desirable that such a general policy include are enumerated below.

(1) Credit agencies should adjust debts only to the point where, in the individual case, the recovery expected by this means is no less than that obtainable through other means, i.e., liquidation of the security, if secured debts are involved. However, in order to remedy the situation which now exists because excessive debts due the Federal Government have not been eligible for compromise or scale down and do not become outlawed as do debts due private creditors or government corporations, it is believed that special attention should be given to adjusting old unsecured debts where there is no present prospect of payment within a reasonable length of time but where the presence of such debt precludes the debtor from obtaining a satisfactory adjustment of his other debts or new financing from other sources.

(2) Reductions deemed desirable in unsecured debts or those secured by personal property should be effected at the time the debt adjustment agreement is reached.

(3) Reductions in debts secured by real estate mortgages may be determined immediately or may be deferred by agreement

for a specified period of time when the debt paying capacity of the debtor or the security cannot be estimated satisfactorily at the time the debt adjustment agreement is developed. Likewise, where the amount of the reduction is determined immediately the final recognition of such reduction may be deferred for a specified period of time under an agreement which will provide that the debtor is to demonstrate his ability to meet the debt payments as adjusted as well as meet other standards of performance which may be agreed upon before the adjustment becomes fully effective.

(4) Where a substantial reduction is to be effected in debt secured by a real estate mortgage, the debtor, if the creditor agency so desires, will transfer title to the property to the creditor under an agreement that a lease with option to repurchase be given the debtor, providing for a reasonable rental during the lease period, and that the debtor will have a definite right to repurchase the property at the end of the lease period either at a fixed price or at a price to be determined under a method agreed upon in advance. The creditor agency should avail itself of the safeguards afforded by this procedure where it is necessary to do so to protect its interests but full consideration should be given to the effect which such action may have on the debtor and the rights of other creditors.

(5) The credit agencies which cooperate in the debt adjustment program should not be expected to furnish rehabilitation credit unless that is their ordinary function; likewise, other assistance rendered by credit agencies to debtors whose debts have been adjusted, such as farm management aid should be confined to that which can be justified on the basis of the financial interests of the agency. In other words, the purposes and functions of each agency should be observed and participation in a debt adjustment program should not require a credit agency to go outside of its general field of operations. Nor on the other hand should such participation be used as a vehicle to shift the losses and burdens of such credit agencies to some other agency of the Government.

Recommended Legislation

In order to carry out the foregoing program, it is believed that the following legislation is needed:

(1) That Federal credit agencies be granted authority to compromise and reduce farm debts under rules and regulations prescribed by the Secretary of Agriculture in accordance with the general policy previously set forth in this memorandum.

(2) That an organization and facilities be set up under the direction of the Secretary of Agriculture to administer the debt adjustment program described herein; such organization to be separate and apart from any agency engaged in extending credit.

(3) That rehabilitation funds be provided to aid in making debt adjustment work most effective; such funds to be provided to the extent justified by the public interest.

(4) That, where additional capital funds are required by a Government credit agency to permit it to participate in the debt adjustment program recommended herein and still carry out the purposes and functions for which it was created, such additional capital be supplied to the extent justified by the public interest.

Committee Members

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	D. C. Horton	BAE	
	R. W. Hudgens *	FSA	
	E. C. Johnson	FCA	
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	C.H. Schwartz, Jr.	"	
	Norman J. Wall	BAE	
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Each subcommittee report has been signed by members of the subcommittees.

*Mr. Hudgens took part in the earlier discussions of this subcommittee, but was unable to attend many of the meetings, and it was not possible for him to review the final draft.